



**STATE LOTTERY COMMISSION
TWO YEARS ENDED JUNE 30, 2003**

**From The Office Of State Auditor
Claire McCaskill**

**Report No. 2004-65
August 31, 2004
www.auditor.mo.gov**

AUDIT REPORT



Office Of
Missouri State Auditor
Claire McCaskill

August 2004

The following problems were discovered as a result of an audit conducted by our office of the State Lottery Commission.

An audit issued July 2, 2004, reviewed the cost of promotional items of all state departments including the State Lottery Commission (SLC). This report (2004-55) concluded the commission gave promotional items to attendees at meetings and conferences, paid to sponsor a golf hole at the Petroleum Marketers Association annual golf event, and gave retailers television sets and DVD players to enhance their working relationships. This report questioned the value received by the SLC from these expenditures. Additionally, follow-up on the State Lottery Commission audit report number 2002-05 found all recommendations either fully or partially implemented.

All reports are available on our website: www.auditor.mo.gov

YELLOW SHEET

STATE LOTTERY COMMISSION

TABLE OF CONTENTS

	<u>Page</u>
STATE AUDITOR'S REPORT	1-3
MANAGEMENT ADVISORY REPORT - STATE AUDITOR'S FINDINGS.....	4-5
FOLLOW-UP ON PRIOR AUDIT FINDINGS	6-10
HISTORY, ORGANIZATION, AND STATISTICAL INFORMATION.....	11-16
<u>Appendix</u>	
A Revenue and Expenditure Data Two Years Ended June 30, 2003	14
B Revenue and Expenditure Charts January 20, 1986 through June 30, 2003	15
C Revenue and Expenditure Charts January 20, 1986 through June 30, 2003	16

STATE AUDITOR'S REPORT



CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Bob Holden, Governor
and
State Lottery Commission
and
James R. Scroggins, Executive Director
State Lottery Commission
Jefferson City, MO 65102

The State Auditor is required under Section 313.315(1), RSMo 2000, to audit the State Lottery Commission. The commission engaged Cochran, Head & Co., P.C., Certified Public Accountants (CPA), to audit the commission's financial statements for the years ended June 30, 2003 and 2002. To satisfy our statutory obligation and minimize duplication of effort, the State Auditor has used the work of the CPA firm. We reviewed the reports and substantiating working papers of the CPA firm to satisfy ourselves as to the appropriateness of using the reports, and we accept them in partial fulfillment of our responsibility under Section 313.315(1), RSMo 2000. The additional objectives of this audit were to:

1. Review compliance with certain legal provisions.
2. Evaluate the economy and efficiency of certain management practices and operations.
3. Follow-up on the status of implementation of prior audit recommendations.

Our methodology to accomplish these objectives included reviewing minutes of meetings, written policies, financial records, and other pertinent documents; interviewing various personnel of the agency, as well as certain external parties; and testing selected transactions.

In addition, we obtained an understanding of internal controls significant to the audit objectives and considered whether specific controls have been properly designed and placed in operation. However, providing an opinion on internal controls was not an objective of our audit and accordingly, we do not express such an opinion.

We also obtained an understanding of legal provisions significant to the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract, grant agreement, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting significant instances of noncompliance with the provisions. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion.

Our audit was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This information was obtained from the agency's management and was not subjected to the procedures applied in the audit of the agency.

The accompanying Management Advisory Report presents our finding arising from our audit of the State Lottery Commission.



Claire McCaskill
State Auditor

April 30, 2004 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	John Blattel, CPA
In-Charge Auditor:	Christina Davis
Audit Staff:	Terri Crader
	Zeb Tharp
	Wendy Groner

MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

STATE LOTTERY COMMISSION
MANAGEMENT ADVISORY REPORT-
STATE AUDITOR'S FINDINGS

Promotional Items

A separate audit was performed which reviewed the cost of promotional items of all state departments, including the State Lottery Commission (SLC). This separate audit report (report number 2004-55) was issued July 2, 2004. This report concluded the commission gave briefcases, vinyl portfolios, rain bonnets, and shoe horns to attendees at meetings/conferences to promote the lottery. Additionally, the SLC paid to sponsor a golf hole at the Petroleum Marketers Association annual golf event. Also, the SLC purchased television sets and DVD players to give to retailers to enhance working relationships with them. The value received by the SLC from these expenditures was questioned in this audit report. Recommendations concerning this issue and the SLC responses were included in that report and are not repeated in this report.

FOLLOW-UP ON PRIOR AUDIT FINDINGS

STATE LOTTERY COMMISSION
FOLLOW-UP ON PRIOR AUDIT FINDINGS

In accordance with *Government Auditing Standards*, this section reports the auditor's follow-up on action taken by the State Lottery Commission on findings in the Management Advisory Report (MAR) of our prior audit report issued for the three years ended June 30, 2001.

1. Sponsorship Agreements

The State Lottery Commission (SLC) does not have a uniform procedure for managing or accounting for tickets received through sponsorship agreements, and various individuals were responsible for different events.

- A. There were some events and tickets for which the SLC could not provide us with detailed documentation regarding who attended the event or how the tickets were distributed. Furthermore, there was no tracking of tickets for minority and women's events.
- B. There is no formal written policy regarding the use of the tickets received or the methods to track the tickets. While reviewing the distribution of the tickets, we noted that the informal policy was not strictly adhered to.
- C. The SLC could not always provide documentation, in the form of a retailer's signature, verifying that the retailer received the tickets indicated.
- D. The SLC does not retain all unused tickets.
- E. In 1995, the SLC purchased 10 personal seat licenses (PSLs) for the St. Louis Rams at a cost of \$45,000. For each year of the audit period, the SLC could only account for six PSL season tickets. SLC employees indicated that the other four season tickets were given to a commissioner to act as an ambassador for the SLC. While the use of one of these ticket is allowed by the informal policy of the SLC, there was no documentation retained indicating who used the three additional tickets given to the commissioner. In contrast to the other tickets received, the SLC does not receive any advertising exposure through the purchase of the PSL tickets except when used in player or retailer promotions.

Recommendation:

The SLC:

- A. Appoint one employee to track all tickets received through sponsorship agreements. This employee should be independent of the marketing department and the minority and women business department. Documentation should be retained to track the receipt and disposition of all tickets obtained through sponsorship agreements.
- B. Establish a formal written policy regarding the use and tracking of tickets received through sponsorship agreements. This policy should include specific guidelines regarding how these tickets are distributed to provide the opportunity for all eligible entities to receive the tickets and to prohibit the tickets from being distributed in an arbitrary manner.
- C. Obtain the signature or other verification of the retailer or other individual receiving any tickets obtained through sponsorship agreements.
- D. Retain all unused tickets obtained through sponsorship agreements.
- E. Reconsider the purchase of season tickets for the St. Louis Rams. The SLC should ensure costs incurred are necessary and reasonable, and provide a benefit to the SLC that justifies these additional costs.

Status:

A, B,
C&D. Implemented.

- E. Partially implemented. The SLC reviewed the purchase of St. Louis Rams season tickets and decided to continue purchasing the tickets. The number of sponsorships is decreasing due to the advertising budget being cut \$2 million in fiscal year 2003 and an additional \$3.2 million in fiscal year 2004. Due to these budget cuts, sports sponsorships decreased from \$1.9 million in fiscal year 2002 to \$1.2 million in fiscal year 2003. The SLC is planning further decreases in sports sponsorships in the next fiscal year. It is too early to predict what effect these cuts will have on sales. Due to recent budget cuts, the SLC should again reconsider whether the purchase of St. Louis Rams season tickets is the best use of limited advertising funds.

2. Advertising Expenditures

The SLC's advertising and promotional expenditures were approximately \$10 million for the years ended June 30, 2001 and 2000; however, a thorough study of

advertising expenditures' effects on sales has not been performed. While reviewing other state lotteries, it was noted that the Massachusetts State Lottery has steadily decreased its advertising expenditures over the past eight years, while its sales have continued to increase.

Recommendation:

The SLC should have an independent reviewer conduct a study of the effectiveness of various types of advertising on the sales of lottery products with the goal of determining if it is possible to reduce advertising expenditures without significantly reducing sales volume.

Status:

Implemented. The SLC requested an independent study be completed by the University of Missouri-Columbia. This analysis was issued in May 2002. The analysis looked at advertising expenditures for 23 months, August 1999 through July 2001, and incorporated random-digit-dialed phone interviews. The conclusion of the analysis was "advertising expenditures are driving sales directly, and they are driving sales indirectly through increasing awareness of the games, positive attitudes toward advertising, and positive attitudes toward the Lottery". This conclusion will be challenged in the future as budget cuts reduced the Lottery advertising budget by more than \$5 million for the two fiscal years ended June 30, 2004. Whether sales will suffer, as suggested by the analysis, will have to be monitored. To date the decrease in advertising has not noticeably reduced sales as fiscal year 2004 sales are the highest in Missouri Lottery Commission history.

3. Prize Check Procedures

Adequate controls are not in place or not always enforced for prize check distribution in the regional offices.

- A. During our review of claims processing, we noted 19 out of 96 prize checks written in the regional offices (20 percent) had only one set of SLC employee initials near the signature line.
- B. A ticket claimant is an individual who completes the back of a winning ticket or a claim form for a winning ticket. The SLC will distribute prize checks to someone other than the claimant if that person is in possession of the winning ticket; however, the check must still be made payable to the claimant. The individual is supposed to sign his or her name on the check register indicating receipt. There were numerous entries on the check register in which the prize winner's signature was illegible, only initials were written, or nothing was indicated.

- C. We scanned two months of the check register for all of the regional offices for any checks that had been marked as void. There were a total of 29 checks that had been indicated as void on the check registers. An explanation for why these checks were voided was not given for any of the 29 checks. Without an explanation the reasonableness of the voided checks can not be determined.
- D During our review of voided checks, we noted that 10 out of 29 voided checks were not retained or not properly marked void. Without retaining the actual, mutilated check, the SLC cannot ensure that the check was voided and will not be cashed.

Recommendation:

The SLC:

- A. Ensure all checks processed in the regional offices are reviewed for accuracy by two employees. In addition, the SLC should ensure this review is documented by initialing on the signature line of each check.
- B. Ensure the name of the individual receiving the prize check is documented in a legible manner, if it is someone other than the claimant. If the check is mailed or otherwise distributed, this should also be documented.
- C. Ensure a reason is indicated on the check register for all checks that are voided by the regional offices.
- D. Ensure voided checks are properly mutilated and retained.

Status:

- A, C
&D. Partially implemented. Our review of prize checks written in the regional offices showed 1 of 25 checks, or 4 percent, where not properly initialed by the signature line. This is an improvement from the 19 of 96 checks, or 20 percent found previously. Errors on voided checks improved from 29 of 29 checks, or 100 percent, to 18 of 37 checks, or 49 percent. Finally, testing showed 1 of 37, or 3 percent, voided checks were not retained, improving from 10 of 29 checks, or 34 percent previously.
- B. Implemented.

HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

STATE LOTTERY COMMISSION HISTORY, ORGANIZATION, AND STATISTICAL INFORMATION

The State Lottery Commission was created June 11, 1985, by Senate Bill No. 44, First Regular Session, 83rd General Assembly. That action followed voter approval of a lottery amendment to the Missouri Constitution at the November 1984 general election. The State Lottery Commission began selling instant game tickets on January 20, 1986.

Section 313.321, RSMo 2000, provides that money received from the sale of lottery tickets shall be divided as follows: A minimum of 45 percent shall be awarded as prizes; administration, advertising, promotion, and retailer compensation costs shall be paid as appropriated by the General Assembly; and the remainder shall be transferred to the Lottery Proceeds Fund to be appropriated solely for institutions of elementary, secondary, and higher education.

A five-member lottery commission is appointed by the governor with the advice and consent of the Senate. The commission must meet at least quarterly. The commission has the authority to promulgate rules as it deems necessary and desirable to fully implement the lottery as mandated by the people in Article III of the Missouri Constitution. It appoints a director to act as secretary of the commission and keep all books and records of the commission. The director of the lottery oversees the commission's operation and administration. At June 30, 2003, James R. Scroggins served as the Executive Director. At June 30, 2003, the members of the commission were as follows:

<u>Commissioner</u>	<u>Term Expires</u>
William E. James, Chairman	September 7, 2001* (1)
Kenneth R. Hensley	September 9, 1998* (2)
Barbara H. Pickering	September 7, 2002*
Sue Carrol Terry	September 7, 2002*
Sherri Robins	September 7, 2006

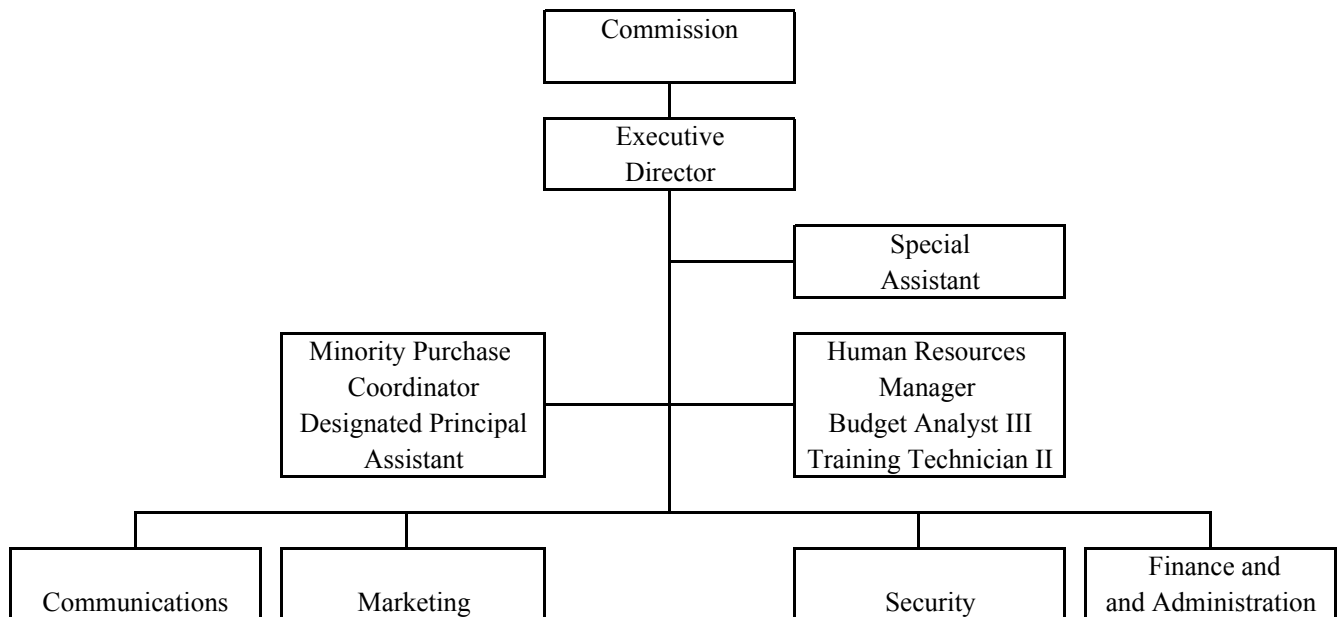
* Commissioners continue to serve until a replacement is named.

(1) Mitchell F. Geilser was appointed April 8, 2004, to replace William E. James.

(2) Kenneth R. Hensley was nominated as chairman on June 23, 2004.

The State Lottery Commission staff is organized into four divisions. Each division is headed by a director who coordinates activities to meet the commission's objectives. At June 30, 2003, the State Lottery Commission employed approximately 175 individuals. An organization chart follows.

STATE LOTTERY COMMISSION
ORGANIZATION CHART
JUNE 30, 2003



Appendix A

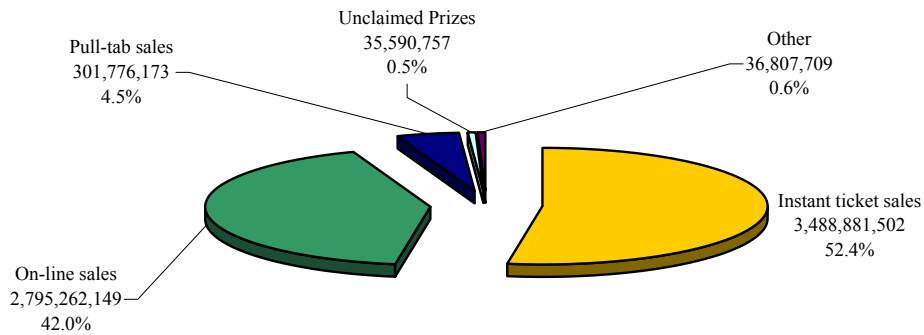
STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE DATA
TWO YEARS ENDED JUNE 30, 2003

		Year Ended June 30,	
		2003	2002
Revenues			
Instant ticket sales	\$	393,981,254	316,397,488
On-line sales		289,025,023	241,422,798
Pull-tab sales		25,041,235	27,368,968
Unclaimed prizes		16,720,584	6,669,140
Other		984,989	1,478,410
Total	\$	<u>725,753,085</u>	<u>593,336,804</u>
Expenditures			
Transfers for Education	\$	203,466,261	160,038,467
Prizes		434,559,460	353,075,456
Administration		43,273,902	43,122,166
Retailer Commissions and Incentives		44,453,462	37,100,715
Total	\$	<u>725,753,085</u>	<u>593,336,804</u>

Appendix B

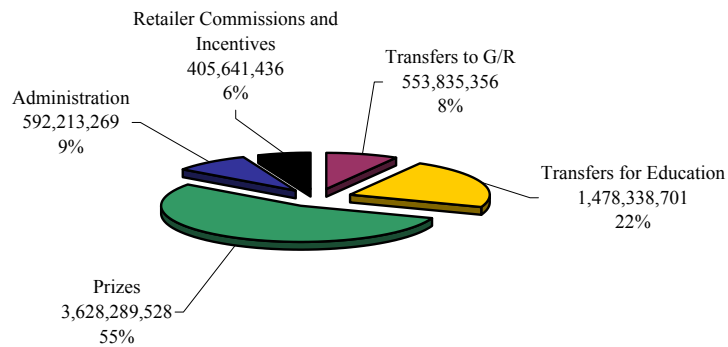
STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE CHARTS
JANUARY 20, 1986 THROUGH JUNE 30, 2003

Revenues



Total Revenues: \$6,658,318,290

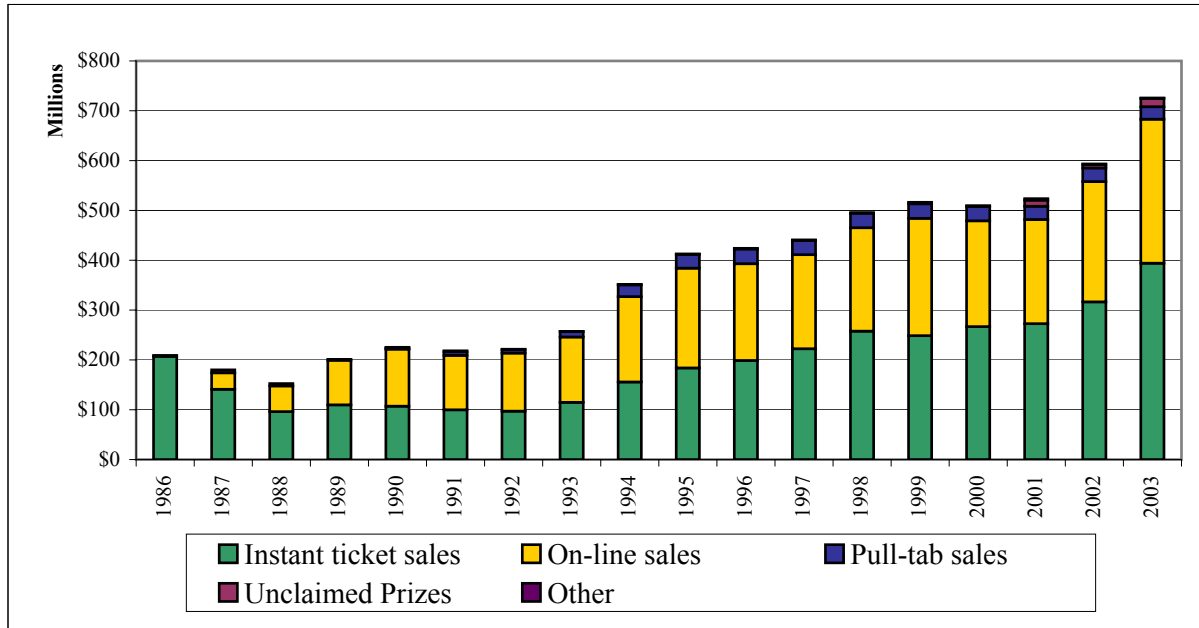
Expenditures



Total Expenditures: \$6,658,318,290

STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE CHARTS
JANUARY 20, 1986 THROUGH JUNE 30, 2003

Revenues



Expenditures

